



## Outlook of UK retail business remains bleak; struggling Debenhams PLC seeks KPMG’s advice

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The outlook of UK retail business remains bleak, as challenges such as intense price competition, falling orders, higher wage and rent costs remain. [Some of the underperformance this year was caused by challenging weather](#) – the snowy weather in the first quarter of the year followed by the heatwave that lasted from July to early August have kept consumers away from high streets, resulting in sales decline. Leading department store operators, John Lewis and Marks & Spencer, have reported [80.5%](#) and [62.1%](#) decrease in their profit before tax respectively. Meanwhile, Debenhams PLC has seen its market capitalization tumble by approximately 70% this year amid the tough environment of the retail business.

T12 Months ending	September 2016	March 2017	September 2017	March 2018
Revenue (GBP mn)	2,341.7	2,365.6	2,335.0	2,303.1
Net Income (GBP mn)	85.9	81.1	48.8	-11.5

Table 1: Income statement data for Debenhams PLC. Source: Bloomberg.

Debenhams has seen its T12M revenue and net income falling since last year (see Table 1). This year, Debenhams issued three profit warnings in [January](#), [April](#) and [June](#), putting the blames on poor Christmas sales, cold weather and “increased competitor discounting and weakness in key markets” respectively for its dismal performance. In September, Debenhams stated that its [full-year profit earnings would be GBP 33mn](#), lower than its previous guidance of GBP 35mn to GBP 40mn. The RMI-CRI 1-year Probability of Default (PD) for Debenhams has increased to 328.9 bps from 121.1 bps, its value before the third warning, which is significantly higher than the 1-year PD for its competitor Marks & Spencer.

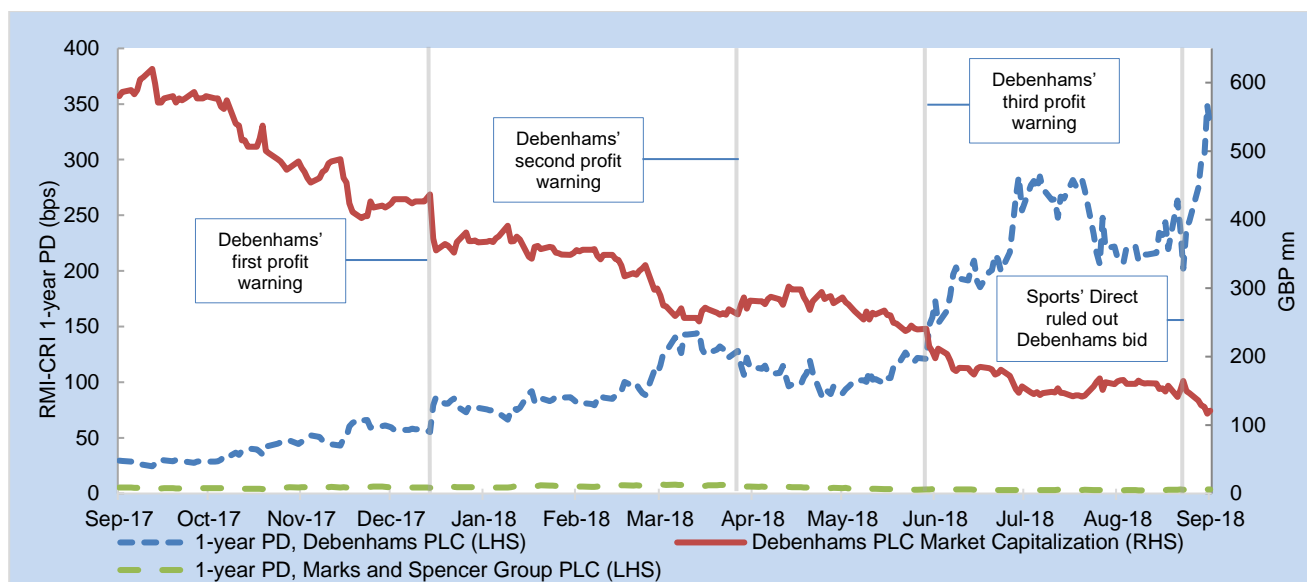


Figure 1: RMI-CRI 1-year PD of Debenhams PLC and Marks and Spencer Group PLC (LHS) and Market Capitalization (RHS) of Debenhams PLC. Source: RMI-CRI, Bloomberg.

Debenhams is in the midst of its 3-year turnaround plan to cut losses and boost sales. If successful, it would be able to improve its EBITDA margin, which has been the lowest among its major competitors since 2017 (see Figure 2b below). To decrease operational costs, Debenhams is considering store closures and has identified 30 stores that could be resized. However, as compared to competitor Marks & Spencer which has a [high proportion of freeholds in its estate, Debenhams stores are mostly leasehold](#), making its cost-cutting efforts more difficult as it must renegotiate lease terms with landlords. Evidently, Debenhams’ Net Debt/T12M EBITDA has increased significantly to 3.79x in 2018, as compared to Marks and Spencer’s 2.14x (see Table 2 below).

Earlier this month, Debenhams [had called in KPMG to advice](#) on its turnaround options, which could include asking creditors, such as suppliers and landlords, to accept a company voluntary arrangement (CVA). This mechanism has been used by retailers such as Mothercare and House of Fraser to impose rent reductions on landlords and break leases to close stores. If effected, this would help speed up store closures.

Company Name	Net Debt/T12 Months EBITDA (X)			
	September 2016	March 2017	September 2017	March 2018
Debenhams PLC	1.37	1.16	2.10	3.79
Marks & Spencer Group PLC	2.10	2.07	1.97	2.14

Table 2: Net Debt/T12M EBITDA for Debenhams PLC and Marks & Spencer PLC. Source: Bloomberg.

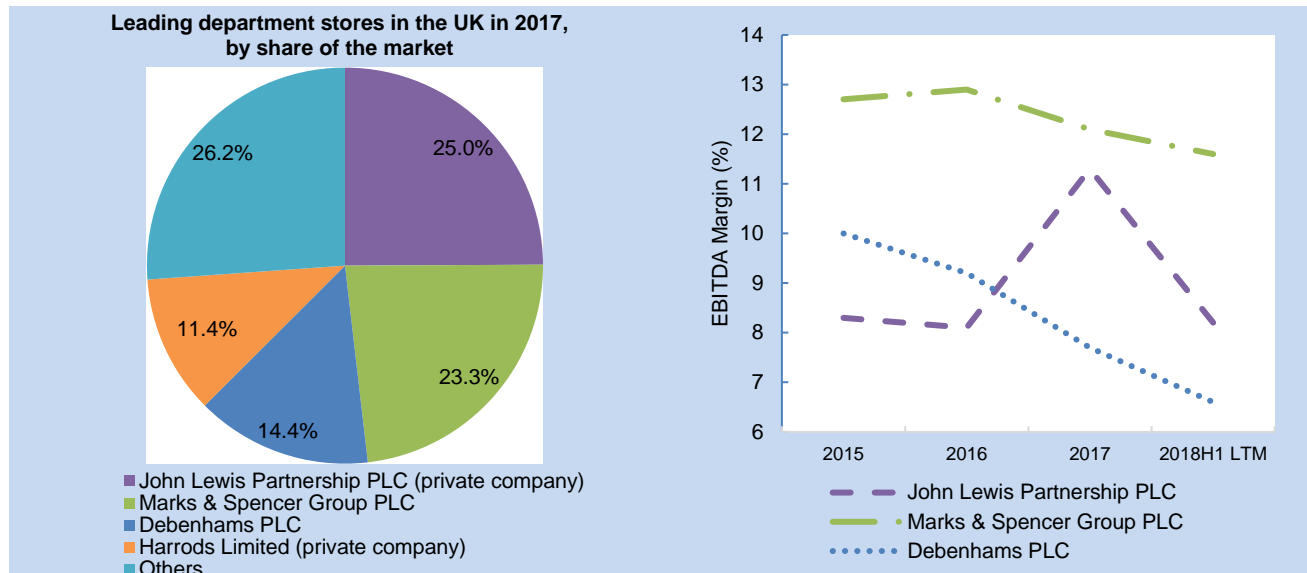


Figure 2a (LHS): Leading UK department stores in 2017, by share of the market. Figure 2b (RHS): EBITDA margin of John Lewis Partnership PLC, Marks & Spencer Group PLC and Debenhams PLC. Source: Global Data, Statista, Bloomberg.

In its pursuit to increase online and overall sales growth, Debenhams has increased its investment in digital transformation by enhancing its mobile platforms through a partnership with Mobify. While [the company reported](#) a significant 11.5% digital sale growth in the 41 weeks to 16 June 2018, it is still not enough to overcome the market challenges as the gross transaction value still decreased by 1.6% in the same period.

Currently, Debenhams is putting hope on its rebranding strategy and greater digital campaign to turn the tides as it seeks to address the changing consumer habits. It recently launched a new logo and new tagline “do a bit of Debenhams” which is part of a bigger marketing campaign to “reclaim the joy of shopping”. Following which, it launched two beauty initiatives which include the creation of UK’s first online beauty community, equipped with loyalty schemes such as monthly benefits, aiming to enhance its leadership in the Beauty market, which sales performance declined in the second quarter. Through such initiatives, Debenhams is hoping to win over competition and gain customer loyalty by capitalizing on peer-to-peer recommendations and enhanced in-store and online experience.

**Credit News**

**Loose leveraged lending is storing up economic trouble, BIS says**

**Sep 24.** The Bank of International Settlement (BIS) warned that the likely distress among indebted borrowers and the growing apathy from investors to protect themselves against losses may spread into the wider economy as central banks raise interest rates. Growth of lending to risky companies has outpaced the sales of those securities and leverage loans now account for almost 45% of the market. More worrying is the increasing trend of covenant-lite lending, which enables investors to hunt for extra yield while waving protections. Other concerns from the BIS report, which includes the prospect of fire sales by loan funds if ratings downgrades push some of their investments into junk. The selling by funds might cause chaos in financial markets as the risk would ultimately get back to the bank balance sheets. ([Bloomberg](#))

**China developers' funding source at risk in sales crackdown**

**Sep 24.** After tightening financing options from bond sales to borrowing from shadow banks, Chinese authorities are considering to scrap so-called pre-sales which allow developers to receive sale proceeds upfront before construction is completed. The pre-sales system helps developers by increasing their leverage and expediting turnover. However in recent times, it spur excessive expansion by developers which increases financial risks. Analysts are estimating that a third of small developers may go out of business in a worst case scenario as developers' cash flow would be stretched. The developers are also facing pressure from its debt as they face a record USD 23bn maturity wall in Q1 2019. ([Bloomberg](#))

**Shadow banker in India rushes to sell assets as defaults pile up**

**Sep 24.** Infrastructure Leasing & Financial Services Ltd (IL&FS), an Indian shadow banker, which has defaulted on more than five of its obligations since August is looking to sell its assets. IL&FS has a total debt of USD 12.6bn and payments on more debt are due in the next few months. There are concerns that the defaults by IL&FS may spread to other shadow banks in India. According to Moody's, IL&FS's outstanding commercial paper accounted for 2% of India's domestic corporate debt market and its bank loans made up about 0.5% to 0.7% of banking system loans. ([Business Times](#))

**Turkey's banks agree to aid debt-laden companies**

**Sep 20.** The Bank Association of Turkey said that the country's lenders would work with struggling companies on their loan repayments. The corporate sector has been saddled with foreign currency debt and a 40 percent decline in the Turkish Lira against the US dollar has led to an unexpected rise in non-performing loans. Turkish investors such as European banks have called the central bank to create a "bad bank" solution to transfer the troubled assets off the banks' balance sheet over to the state. However, concerns remain that Turkey's banks, which are reliant on external financing themselves may also struggle to refinance their debt. ([FT](#))

**USA Inc faces growing threat from activist debt investors**

**Sep 18.** Credit researchers at CreditSights have warned that the increased practice of net short debt activism could destabilize companies and destroy enterprise value held by the firm's bondholders. Many of the debt activists are hedge funds, who purchase a significant enough position in the company for it to declare default and place an even larger position in the company's credit default swap. Observers say that the sluggish US economy and low corporate default rate have compelled fund managers to short healthy companies to generate trading opportunities. ([FT](#))

**World's first unified payment QR code credit positive for Singapore banks: Moody's** ([Business Times](#))

**Banks give China's Web lenders a second life** ([Business Times](#))

**Fed funds rate set to rise past inflation for first time since 2008** ([FT](#))

**Regulatory Updates****US federal agencies approve amendments to swap margin rule**

**Sep 21.** Five federal agencies approved the final amendments to swap margin requirements that will make legacy swaps entered into before the applicable compliance date not subjected to the margin requirements if they are amended solely to comply with the requirements of the qualified financial contracts (QFC) rules. Not only the margin requirements are designed to help to ensure the safety and soundness of swap entities, but they are also designed to reduce risks to the stability of the financial system associated with non-cleared swaps activity. ([Federal Reserve](#))

**EU banks funding plans indicate increased appetite for client deposits and market-based funding in the coming years**

**Sep 19.** 159 banks submitted their plans to the European Banking Authority (EBA) over a forecast period of 3 years. The projected total assets growth, which is on average 6.2% by 2020, is mainly driven by loans to households and to non-financial corporates. Banks expect to increase client deposits and long-term debt funding while short-term debt and repo funding are expected to fall over the forecast period. The expected concentration of debt securities issuance in 2019 and 2020 is driven by the banks to comply with the total loss absorption capacity requirements and the progress in the implementation of the minimum requirements for eligible liabilities. Furthermore, data shows that spread between interest rate for client deposits and for loans to clients declined in 2017 and are expected to further decline in 2018. ([EBA](#))

**China allows direct stock investment with WMP funds** ([Regulation Asia](#))

**Regulators propose new capital treatment for higher-risk CRE exposures** ([American Banker](#))

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